BOCs retain market power and that the section 272 safeguards continue to provide significant pro-competitive benefits.

Most fundamentally, the Commission can and should consider all evidence of BOC misconduct because the purpose of this rulemaking proceeding is *not* to determine whether any BOC (or the BOCs collectively) has engaged in cost misallocation or discrimination and therefore has violated section 272. Indeed, "final regulatory or judicial findings" that a BOC is violating section 272 would prove that the BOC is no longer complying with section 271 (which requires compliance with section 272), and would therefore constitute grounds for suspension or revocation of the BOC's interLATA authority. Here, by contrast, the Commission's more general purpose is simply to determine whether section 272 remains *useful* in detecting such misconduct.[25] As the evidence compiled here shows, such misconduct remains a problem long after interLATA authority is granted and without the section 272 safeguards in place, it becomes far more difficult to detect and remedy.

Moreover, the Commission should consider all types of evidence because, as a practical matter, there is not yet enough marketplace evidence that bears on the BOCs' section 272 compliance to justify examining only final regulatory or judicial actions. Only 15 state section 271 applications have been approved pursuant to section 271; only two of those approvals were made prior to 2001, and most have been approved only in the last six months. In most states where approval has been granted, there simply has not been sufficient time for a regulatory or judicial body to make any final determinations regarding a BOC's compliance with section 272.[26]

[25] *See, e.g.*, *FCC* v. *National Citizens Comm. for Broadcasting*, 436 U.S. 775, 796-97, 813-14 (1981).

[26] In addition, unlike the proceedings at the state level to determine a BOC's compliance with section 271, states have so far been reluctant to conduct proceedings relating to BOC compliance with section 272 – and the Commission has not yet invited such actions, as it did with section 271

Indeed, in many instances, serious allegations of BOC misconduct have been raised, but the regulatory agency has not yet acted.[27]

In this regard, only *one* BOC biennial audit report has been released in unredacted form -- and even in that one instance, the BOC failed to maintain sufficient data regarding many aspects of its compliance with section 272.[28] For this reason, it is critical that the Commission require that the BOCs *promptly* release to the public *all* portions of a biennial audit report, as the Commission already has determined is required by the plain terms of section 272. *Audit Data Disclosure Order* ¶ 12.[29] Because biennial audits are intended to provide a "thorough and systematic evaluation" of a BOCs' compliance with section 272, *BA-NY Order* ¶ 416 & n.1284, it would be patently arbitrary to allow section 272 requirements to sunset even though – because of the BOCs' intransigence – only a single audit report has been publicly released in unredacted form. *See also infra* Part II.D (explaining why the biennial audit requirement alone, particularly where there is no structural separation requirement, is insufficient to constrain BOC use of market power). Additionally, formal evidence or findings of BOC misconduct bearing on section 272 compliance may arise in other audit proceedings, such as the numerous audits relating to merger compliance. Evidence discovered in these proceedings also supports retaining the section 272

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proceedings. As a consequence, there have been fewer state proceedings regarding compliance with section 272.

[27] For example, AT&T showed over a year ago that Verizon was illegally subsidizing Genuity, a company that Verizon had the option of acquiring. *See* Letter of Joan Marsh, AT&T, to Dorothy Attwood & David Solomon, FCC, CC Docket No. 98-184 (filed Aug. 8, 2001). Another example relates to Qwest's misconduct with regard to its agreement to spin off its in-region, interLATA services, which is described below.

[28] Nevertheless, as described below, that audit nonetheless uncovered a disturbing number of section 272 violations. *See also* AT&T Verizon Audit Comments.

[29] Order, *In the Matter of Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket 96-150, (Jan. 10, 2002) ("*Audit Data Disclosure Order*").

safeguards. *See infra* (describing evidence of Qwest misconduct discovered in merger compliance proceedings).

For all these reasons, the Commission can and should consider all types of evidence regarding a BOCs' discrimination and cost misallocation. And even though formal complaints and findings of misconduct are not necessary, AT&T has compiled substantial evidence of such misconduct. This misconduct includes both instances of outright discrimination against rival IXCs and disturbing evidence of cost misallocation that demonstrates that BOCs are manipulating their market power – and the existing section 272 safeguards – to harm interLATA competition. This misconduct demonstrates that BOCs have market power and that section 272 obligations need to be not only retained but strengthened and more vigorously enforced. *See* Texas PUC Comments at 6 (since November 1999, SBC "has paid over $23 million" in penalties in Texas, and in the last six months for which data are available, there are "over 525 separate violations").

1. Discrimination In Provisioning

Provisioning of Special Access. One of the most egregious and competitively harmful ways in which BOCs are abusing their market power is in their discriminatory performance in providing special access services to IXCs competing with the BOCs' interLATA affiliates. Section 272 safeguards, when properly enforced, can play a vital role in detecting, punishing, and deterring this discriminatory performance.

As described above, the BOCs retain significant market power – in all local markets – over the provision of special access facilities. Special access is a critical input for any IXC's services, and timely and accurate provisioning, repair, and maintenance of special access services are critical for IXCs to make firm service commitments and to assure quality service for their end user customers. *See NYPSC Special Access Order* at 10 ("special access services "are crucial for the development of facilities-based competition"). However, the BOCs' performance with regard to these critical aspects of special access service shows a consistent pattern of poor quality, delays, and other discrimination against the BOCs' rival IXCs and in favor of the BOCs, their IXC affiliates, and their retail customers.

Several state commissions have investigated the BOCs' special access performance and determined that it is entirely inadequate and discriminatory. The NYPSC has ruled that the evidence before it demonstrated that Verizon "provides special wholesale services in a discriminatory manner." *NYPSC Special Access Order* at 6.[30] The data compiled by the NYPSC suggested that Verizon missed very few provisioning appointments for its retail customers, but missed over 25 percent of appointments scheduled by rival IXCs. *Id.* at 5. The NYPSC found that "these delays indicate Verizon's provision of Special [Access] Services is below the threshold of acceptable quality" and that "Verizon treats other carriers *less favorably* than its retail customers." *Id.* at 6 (emphasis added). Significantly, these state commission findings of discriminatory performance were made for the BOC that was approved under section 271 *in 1999* and for the local market that is the most developed in the country. Despite the passage of nearly three years since Verizon's affiliate entered the in-region interLATA market and the emergence of some minimal local competition in New York, the PSC has nevertheless concluded that Verizon remains the dominant provider of special access in *all* areas of New York, and that its performance in providing those critical inputs is both inferior *and* discriminatory.

[30] The NYPSC found that Verizon's "provision of Special [Access] Services . . . began to deteriorate during 1995, and continued to decline in 1996." *NYPSC Special Access Order* at 4. Even "one full year" after the NYPSC acted to require Verizon to improve service quality, the "service results were mixed, at best." *Id.* at 4. Although some improvement was made in 1998 (notably, the time period in which Verizon was seeking the NYPSC's support for its section 271 application), the NYSPC found that it "was not sustained." *Id.*

These NYPSC findings were corroborated by the Biennial Audit performed for Verizon. The audit collected data on four aspects of special access performance: average installation interval, installation commitments met, average repair interval, and total trouble reports. Even though the audit measurements were insufficient in a number of fundamental respects,[31] the limited data that was provided in the audit confirmed that Verizon's special access performance was blatantly discriminatory. For example, the data showed that installation of special access services for non-affiliated carriers took far longer than for Verizon 272 affiliates: in June, 2000, the mean for installation of high speed special access for Verizon affiliates was just 9.9 days, but was 25.3 days for competitors. *See* AT&T Audit Comments at 16-22 & Bell Decl. ¶¶ 43-44.

In fact, review of virtually *every* report for each of the four special access performance measures indicates that Verizon's affiliates received more favorable service than competitors. *See* AT&T Audit Comments at 19-20 (citing Verizon Audit, Table 14a, 14b. 14c). For example, in six of the nine months surveyed, the results showed that the Verizon 272 affiliates' orders were installed significantly faster than competitors' orders (results in days):

	High Speed Access		All Special Access	
	Verizon 272	Competitors	Verizon 272	Competitors
March	15.5	28.6	15.2	23.9
April	17.0	23.8	12.3	21.4
May	23.2	38.0	23.2	31.4
June	9.9	25.3	9.9	22.5
July	21.0	32.8	19.0	29.0
Sept.	30.0	59.2	30.0	48.1

[31] Most notably, Verizon simply failed to collect or maintain much of the data that is necessary to measure its special access performance. For example, the relevant performance data was often retained for a period shorter than the nine months that the audits attempted to examine. Comments of AT&T Corp. CC Docket 96-150, at 14-15 (filed Apr. 8, 2002); ("AT&T Audit Comments").

See id. As this chart indicates, in the last month for which data was collected, it took Verizon nearly *two months* to install high speed special access circuits for competitors – twice as long as for its own 272 affiliates.

Likewise, on the measure for Percent Commitments Met, there was again consistent bias in favor of Verizon's 272 affiliates: in a number of months, the affiliates received 100% on-time performance from Verizon; competitors *never* received this level of performance. AT&T Audit Comments at 20-21. And once again, in six of the nine months, Verizon's 272 affiliates received more timely service than competitors (figures in percentage of commitments met):

	High Speed Access		All Special Access	
	Verizon 272	Competitors	Verizon 272	Competitors
Feb.	100%	83.9%	100%	84.4%
March	92.3%	85.7%	93.8%	87.6%
May	90.9%	85.0%	90.9%	85.9%
June	90.4%	82.2%	83.8%	83.8%
July	100%	77.7%	75.0%	80.0%
Aug.	100%	72.5%	100%	72.8%

Id. Table 14a. As for trouble tickets, the 272 affiliates had just nine reports in all, while competitors always had thousands per month. *Id.* The average repair interval for trouble tickets was also longer for competitors in the two months for which comparisons can be made. *Id.* Thus, even the limited data provided in the Biennial Audit thoroughly demonstrates that Verizon continues to discriminate in providing and repairing special access services nearly three years after receiving interLATA authority.

Several other state commission have also concluded that the BOCs' special access provisioning in inferior. For example, the Minnesota PUC, after reviewing a complaint filed by AT&T, concluded that there was a

> clear need for further investigation, careful monitoring, and, potentially, wholesale access service quality standards for [Qwest, because] ensuring reliable, high quality long distance service between all Minnesota households and businesses is one of this Commission's highest priorities. The record in this case raises the serious possibility that the quality of [Qwest's] wholesale access services may jeopardize this important goal.[32]

Likewise, in another state complaint case, the Colorado Public Utilities Commission found serious problems with special access provisioning:

> AT&T has experienced regular, frequent, widespread, and ongoing delays in obtaining access . . . When [Qwest] does not meet its dates for the provision of service, it works a hardship on AT&T as well as AT&T's customers . . . On a region-wide, multi-state basis, [Qwest] has provisioned DS1s and DS0s to AT&T on a wholesale basis after a longer interval than it provided those same services to other wholesale customers.[33]

These findings are all the more significant because publicly available data on BOC' special access performance is generally inadequate – often because the BOCs have insisted upon hiding such data from the public view. The findings and data on special access performance collected by state commissions is limited because many of them have hesitated to assert jurisdiction over the BOCs' performance in providing special access services, which are used primarily for interstate traffic. *See* AT&T Special Access Comments at 21. Moreover, although ILECs provide service quality data to IXCs for business purposes, such data are typically subject to confidentiality agreements that forbid IXCs from disclosing the data or that require IXCs to seek ILEC approval before doing so. Further, although the Biennial Audit report for SBC in Texas was released on December 17, 2001, SBC redacted *all* of the performance data for special access services – notwithstanding the Commission's express holding that public comment on such

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[32] MPUC Docket No. P-421/C-99-1183, *Complaint of AT&T Communications Of the Midwest Inc. Regarding Access Services*, 2000 Minn. PUC Lexis 53, *34 (Aug. 15, 2000).

[33] CPUC Docket No. 99F-404T, *AT&T Communications of the Mountain States, Inc. v. U S West Communications, Inc.*, Decision No. R00-128, at II.D, F, G (Feb. 7, 2000); *see also* Texas PUC Comments at 7-8 (noting its investigation of SBC's provision of special access).

data is a "critical component[] in ensuring compliance with the separate affiliate safeguards and promoting competition in the market for in-region interLATA telecommunications." *Audit Data Disclosure Order* ¶ 12.

Despite the BOCs' efforts to suppress data regarding their special access performance, AT&T recently submitted testimony to the Commission that, on a national, aggregated basis, tracked performance trends for special access over the last five years. *See* Declaration of Maureen Swift on Behalf of AT&T Corp. (Filed Feb. 12, 2002, CC Docket 01-321). That analysis demonstrated that ILECs consistently fail to provision DS-1 orders in a timely manner – in the five years AT&T examined, the ILECs failure rate was as high as 23 percent, and it never fell below 10 percent. *Id.* ¶¶ 10-12. Moreover, the data reflect a *downward* trend in on-time performance. And AT&T's national data also showed that ILECs fail to respond to outages in a timely fashion. *Id.* ¶ 11.

Thus, the evidence regarding BOCs special access performance – including evidence compiled by state commissions, by IXCs, and by independent auditors – demonstrates that BOCs retain market power in local markets long after interLATA entry and are using that power to favor its own affiliates and customers. Section 272 safeguards – along with a federal performance plan and enforcement mechanisms – are vital tools in constraining the BOCs' ability to deny rival IXCs nondiscriminatory access to special access services and other key inputs to interLATA services.

PIC Process and PIC Freezes. Vital and robust competition in the interLATA market is also critically dependent upon the PIC process, which is the method for a customer to change its primary long distance carrier and which allows IXCs to win customers to the IXCs' interLATA services in a rapid and efficient manner. Because of their dominance in local markets, BOCs retain control over the PIC process. *See* Selwyn Dec. ¶¶ 37-38 (explaining BOC advantage derived from monopoly status). As a consequence, BOCs have obvious incentives to use the PIC change process in myriad ways to favor their long distance affiliates and customers. The BOCs, for example, not only implement PIC changes that favor their affiliates more quickly, but also engage in myriad additional forms of discrimination, like routinely placing a "PIC freeze" (a process which makes it more difficult for a customer to change its local carrier) on customers that select BOC affiliates' long distance services. *See also* Texas PUC Comments at 6 (finding a "clear violation of existing state law and the [Act's] pro-competitive policies" where SBC refused to allow CLEC customers to presubscribe to SBC's intraLATA toll service) Even though data relating to the PIC process is even more limited than data on special access, there is substantial evidence that BOCs have manipulated that process to favor their interLATA affiliates and to discriminate against rival IXCs.

An ALJ of the California Public Utilities Commission, for example, recently determined that "a substantial possibility of harm to the intrastate long distance telephone market exists from [the BOC's] continuing role as the [PIC] administrator." *California ALJ Decision* at 256.[34] The ALJ recognized that there is a "tension between [the BOC's duty to administer PIC changes in a competitively neutral way and its interest in winning customers." *Id.* The ALJ found that Pacific Bell "failed to offer any assurance that it would perform its [PIC administrative] role with any safeguards of neutrality or sensitivity to competitor concerns." *Id.* at 256-57. And the Judge relied on a partial audit that found "problems with a significant percentage of" disputed PIC changes administered by Pacific. Accordingly, the California ALJ concluded that, unless PIC changes were handled by a neutral administrator, "there is a substantial possibility that the

[34] Draft *Decision*, Rulemaking R.93-04-003 (Filed July 23, 2002) ("*California ALJ Decision*").

intrastate interexchange telecommunications market will be harmed through increasing customer dissatisfaction and carrier conflicts." *Id.* at 257.

In Colorado, Qwest unilaterally extended PIC freezes the day that intraLATA presubscription was implemented in Colorado – the first time that customers were able to choose their intraLATA carrier. By extending the freeze to the intraLATA carrier, Qwest froze *itself* as virtually all customers' carrier, thus impeding customers' ability to choose a carrier other than Qwest. Qwest rejected thousands of customers' orders to switch away from Qwest. AT&T and other carriers filed complaints regarding Qwest's action, and an ALJ found that the institution of the freeze was unlawful. *Before the Public Utilities Commission of the State of Colorado,* Docket No. 99K-193T, Decision No. C00-301, March 22, 2000. The ALJ found that Qwest "used its position as the sole 1+ intraLATA provider in its extensive service area to inhibit the entry of competitors into the intraLATA market and tangibly damaged the entering competitors." *Id.* I.(E.)(2.). The Commission also found that Qwest's "abuse of its market position to inhibit and damage competition was anticompetitive." *Id.*

It is clear that this problem does not disappear with section 271 approval or the passage of time. The Verizon biennial audit collected information regarding Verizon's processing of PIC changes. Even though the audit examined only a single aspect of that process, the data collected in the audit provided significant evidence of discrimination: in all five months covered by the audit, it took substantially longer for Verizon to implement competitors' PIC changes than those of Verizon's affiliates. AT&T Audit Comments at 18 n.11, 19-20 & Bell Dec. ¶ 45. In one month, for example, it took Verizon over three times as long to process competitors' PIC changes.

The BOCs also cause significant harm to the interLATA market by manipulating the PIC freeze process. In particular, AT&T and other IXCs have developed evidence that demonstrated that Verizon has persistently abused its ability to discriminate in the administration of the PIC freeze process to advantage its own toll services and disadvantage its New York competitors. *See* Letter of Harry M. Davidow, AT&T, to Hon. Janet H. Deixler, New York, P.S.C., Cases No. 00-C-0897 et al (Jan. 18, 2002). For example, IXCs have shown that Verizon (i) imposes PIC freezes on its own toll accounts without customer consent (thus making it more difficult for rivals to switch over customers they win from Verizon), (ii) disrupts the three-way calls that are typically used to lift PIC freezes, and (iii) gives preferential treatment to customers seeking to come to Verizon long distance that have PIC freezes on their toll lines. *Id.* at 2. In addition, AT&T recently submitted evidence to the New York PSC demonstrating that Verizon officials would often simply ignore or override a customer's valid PIC freeze when seeking to convert that customer to Verizon long distance. *Id.* at 4. Section 272 discrimination safeguards, if enforced, can play a vital role in detecting and preventing such misconduct.

"Growth" Discounts. In addition, the BOCs have also sought to use their market power to discriminate against rivals and in favor their affiliates in rates for switched access services. The Commission has already given special attention to schemes by which a BOC may be able to establish rates that appear to be facially neutral, but in fact have an unlawful, discriminatory impact. In the *Non-Accounting Safeguards Order*, the Commission recognized that "a BOC may have an incentive to offer tariffs that, while available on a nondiscriminatory basis, are in fact tailored to its affiliate's specific size, expansion plans, or other needs." *Id.* ¶ 257. The Commission specifically noted that "growth discounts," which offer reduced prices based on growth in local traffic, "create an artificial advantage for BOC long distance affiliates with no

subscribers, relative to existing IXCs and other new entrants." *See Access Charge Reform NPRM* ¶ 134.[35]

The Commission has also recognized that BOC affiliates, which "will begin with existing relationships with end users, name recognition, and no subscribers," will be able to "grow much more quickly than existing IXCs and other new entrants." *Non-Accounting Safeguards Order* ¶ 192. It has further recognized that "incumbent LECs could circumvent the nondiscrimination provisions of section 272 by offering growth discounts for which, as a practical matter, only their affiliates would qualify." *Id.* In light of this risk, and finding that growth discounts offered "no affirmative benefit" to the development of competitive access markets, the Commission expressly prohibited the use of growth discounts in interstate switched access service tariffs. *Access Charge Reform NPRM* ¶ 135.

BellSouth has nonetheless recently proposed a tariff that would establish a discriminatory growth discount that would favor BellSouth's long distance affiliate ("BSLD") over large, established IXCs such as AT&T.[36] BellSouth's tariff, which offers discounts based on percentage growth from a fixed customer base, has a discriminatory impact on established IXCs because they start from a large customer base, from which it is difficult to grow annually on a high percentage basis. *See* AT&T Alabama 271 Comments & King Decl. ¶ 12. Similarly, the gradual expansion of local competition in the BellSouth service territory will mean that, for an increasingly substantial number of calls, a CLEC – not BellSouth – will be the access carrier, and established IXCs will owe access charges to various CLECs rather than to BellSouth. *Id.* BSLD,

[35] *Access Charge Reform*, Fifth Report And Order And Further Notice Of Proposed Rulemaking, 14 FCC Rcd. 14221 (1999).

[36] *See* Comments of AT&T Corp., WC Docket No. 02-150, at 47-51 (filed July 11, 2002) ("AT&T Alabama 271 Comments").

on the other hand, will begin with a very small customer base. As BSLD enters the interLATA market, however, it will be able to leverage BellSouth's monopoly customer base into a large share of the long distance market, mostly at the expense of the large IXCs. *Id.* Thus, even though AT&T's total access minutes may be significantly larger than those of BSLD, BSLD will be able to show "growth" in its initially small volumes, and on that basis obtain a larger volume discount and lower access charges than AT&T and other large IXCs. *Id.* ¶ 6. Such tariffs confirm market power and squarely violate the section 272 non-discrimination provisions.

2. Cost Misallocation

In addition to discriminatory misconduct, the BOCs have also engaged in an array of activities designed to misallocate costs in order to distort competition in interLATA markets. Through use of the BOCs' market power, the BOC can allocate costs and otherwise structure their local operations in a manner that favors the BOC's own long distance operations and harms those of competitors. *See Verizon*, 122 S. Ct. at 1662. Section 272 safeguards can help carriers and regulators detect and attempt to remedy this conduct.

Price Squeezes for Access Services. Because BOCs control the facilities used to provide access services, which are a key input into long distance services, the BOCs have the incentive to price access services at rates above the cost of providing the access services. And it well-established that, regardless of the method by which the BOCs' prices for its local services are regulated, BOCs generally have the ability to act on that incentive, and price access at above-cost rates. That, of course, enables the BOC to offer its own long distance services at prices that undercut those that can profitably charged by rival IXCs.

There is considerable evidence that BOCs – including BOCs that have long had section 271 authority – are engaging in price squeezes. As AT&T explained in a complaint with the Public Utility Commission of Texas, SBC's long distance affiliate began offering intrastate long distance services at very low rates that are nearly equal to SBC's intrastate access charges and that therefore could not possibly allow the SBC affiliate to cover all of its costs.[37] Some of the plans offered by SBC's long distance affiliate offer long distance service for as low as 6 cents per minute for residential customers and as low as seven cents per minute for business customers. *AT&T Price Squeeze Complaint* at 6-7. Yet the access charge that applies to a residential intrastate long distance call between SBC customers is about 5.67 cents per minute. *Id.* at 7. On such calls, SBC's affiliate gains net revenue of just a few tenths of a cent. However, it is evident that the affiliate's own operating expenses are significant, and along with the access cost, far exceed the retail rates that SBC's affiliate is charging. Indeed, based upon agreements that SBC has summarized as a result of its section 272 obligations, AT&T has been able to estimate that the SBC long distance affiliate incurs billing and marketing expenses of at least 3.4 cents per minute. *Id.* at 8. In these circumstances, even if the SBC long distance affiliate loses money on these calls, the SBC entity as whole has realized a net profit.[38] Based on these pricing patterns, AT&T alleged that SBC's long distance rates were below-cost, result in a price squeeze, and are anti-competitive. *Id.*

[37] *See* Second Amended Complaint of AT&T Communications of Texas, L.P., SOAH Docket No. 473-01-1558, Docket No. 23063 (Texas P.U.C. filed Dec. 5, 2001) ("*AT&T Price Squeeze Complaint*").

[38] SBC seeks to maximize the profit of the entire entity, and is indifferent to whether its long distance affiliate makes money. In fact, this was made particularly evident recently when SBC witnesses provided testimony before the Texas legislature regarding proposed tax legislation that would eliminate the ability of a surviving corporation in a merger to carry forward the losses of the other merged company. The SBC witness stated that SBC plans to merge its affiliates into its BOC operations when it is permitted, and that SBC will want to use the losses of those companies to offset any profits of the BOC. Partial Tr., Before the Senate Comm. on Finance, Austin, Texas, *Relating to the Franchise Tax*, S. Bill 1689 (Testimony of T. Leahy, SBC, Apr. 19, 2001). This further demonstrates that the section 272 separation requirements must be maintained and rigorously enforced to prevent this blatant cost misallocation.

As explained in Dr. Selwyn's testimony, the BOCs' own expert economists have themselves provided the theoretical explanation that corroborates the practical evidence of this pricing pattern. Selwyn Dec. ¶¶ 49-61. These BOC economists claim that two affiliated companies that have vertical supplier-customer relationship – as do a BOC and its interLATA affiliate – will engage in "double marginalization," which will result in the companies setting the price of the "downstream product" (i.e., long distance) to "maximize its profits jointly." *See id.* (citing BOC expert report). That occurs, these economists assert, because the BOC retains an "access margin," or access rates above cost, which makes it profitable for the entity as a whole to lower the price of long distance, regardless of the stand-alone profit of the downstream company. *See id.* ¶ 50. As Dr. Selwyn explains, such conclusions can only be true if the BOCs in fact continue to have market power, ignore the section 272 separation safeguards, and violate access cost imputation arguments. *Id.* ¶¶ 49-55.

Significantly, section 272 can play a significant role in detecting whether a price squeeze is in fact occurring. *See* Selwyn Dec. ¶ 59. At a minimum, section 272 requires the BOC's long distance affiliate to maintain separate books and records and to impute to itself or its affiliate the access charges it levies on IXCs. As Dr. Selwyn explains, these requirements, when applied and properly enforced, can provide a valuable mechanism to detect price squeezes and other cost misallocations. *Id.* Another potentially important safeguard is the requirement that BOCs post summaries of their affiliate transactions. *See id.* ¶¶ 13, 56. As in AT&T's Texas Complaint, such information can be relevant to determine whether the BOC affiliate is being charged an appropriate rate for the goods or services it obtains from the BOC, and how the affiliate's costs are aligned with the rates the affiliate is charging others. Indeed, because of the potential value of such information, many BOCs – including, as described below, SBC – have taken measures to avoid their section 272 obligations to report their affiliate transactions. This misconduct not only demonstrates the market power of the BOCs, but also the ways in which section 272's safeguards can be useful in detecting BOC abuse of that market power.

Inter-Affiliate Transfers. There is also substantial evidence that BOCs are transferring significant and competitively valuable assets among their affiliates, but are refusing to price the assets at anything remotely close to the full and fair market value of these assets. What it worse, there is mounting evidence that certain BOCs are transferring significant operations formerly performed by the BOC to an unregulated affiliate, so that such operations can be provided to other affiliates on an ongoing basis without being subject to section 272 disclosure safeguards. As a result, BOCs are able to hide from public view the prices their section 272 affiliates pay for operations that the BOC once provided pursuant to contracts that were disclosed pursuant to section 272. This misconduct again demonstrates both the BOCs' market power and the continued need for section 272 safeguards – including reinvigorated enforcement of those safeguards – to prevent the BOCs' from misusing that market power to favor their affiliates and harm long distance competition.

Although the scope of these inter-affiliate transfers is vast, transfers of assets relating to customer acquisition and marketing stand out, both because of the documented evidence that BOCs are essentially giving away such services to their affiliates and because of the serious competitive harm that results from such anticompetitive activity. As Dr. Selwyn describes, by virtue of the BOCs' monopoly status, they acquired a massive customer base as well as ready access to a steady stream of inbound, customer-initiated contacts. Selwyn Dec. ¶¶ 37-38, 63. In particular, as a recent audit report in California described, BOCs like Pacific Bell have over many years developed extensive and massive customer databases, which contain substantial and valuable customer information like customer names, addresses, and phone numbers, as well as "detailed historical information concerning customer telecommunications services and credit."[39] The BOCs have used these advantages to provide marketing services and assets to their affiliates at reduced costs – or in some cases simply for free.

As the recent opinion of the California ALJ described in crediting testimony offered by a competing carrier regarding a proposed BOC marketing plan, the BOC long distance affiliate, "through its position as the incumbent, . . . obtains marketing access to millions of potential interLATA customers at a cost that is far below either the cost to the RBOC to produce the joint marketing services, or the fair market value of the service." *California ALJ Decision* at 251-52. Specifically, the ALJ noted evidence showing that, although the fair market value of new customer acquisition costs ranged from about $300 to $500 per sale, the BOC long distance affiliate was paying the BOC a mere $3.54 per sale. *Id.* at 252 n.376. The ALJ determined that the BOC's "proposed joint marketing plan clearly demonstrates cross-subsidization, and we find it very troubling" – in particular because of the "economic detriment [to] the local ratepayers." *Id.* at 252. The ALJ concluded that the BOC needed to "re-examine" its plans, and warned that, if cost misallocation was later uncovered in the final plans, "we will not hesitate to take the strongest action." *Id.* at 253. This misconduct is quite common among the BOCs; as Dr. Selwyn describes, Verizon has engaged in a very similar scheme in which its long distance affiliate pays just $7.71 per contact – a figure that Verizon claimed was justified because it "could not . . . obtain" a fair market value for such services. *See* Selwyn Dec. ¶ 65.

[39] Supplemental Report, Regulatory Audit of Pacific Bell for the Years 1997, 1998, and 1999 at S12-4, S12-6 (prepared for the Cal. PUC by Overland Consulting, dated June 20, 2002) ("*Overland Supp. Cal. Audit*").

In addition to marketing services, BOCs also apparently provide their interLATA affiliates with *free* access to the valuable customer databases that BOCs have compiled. A recent audit of Pacific Bell discovered that "SBC began transferring Pacific Bell's customer service, marketing, and sales functions to SBC Operations, a corporate shared services affiliate." *Overland Supp. Cal. Audit* at S12-1. The transfers also include "Pacific Bell's customer database," but the auditors determined that "Pacific Bell has not been compensated for the transfer." *Id.*[40] That is entirely unjustified, because the auditors noted that the data could "be used for a variety of purposes by a wide range of subsidiaries" – including SBCs long distance affiliates. *Id.* at S12-7; S12-1. The auditors found that "the most obvious benefit provided by access" to the database is "sales leads," but other benefits included the ability to develop "marketing strategies" and to "piggyback" on the database in order to "maintain an ongoing picture of their relations between their customer and their service base." *Id.* at S12-4, S12-7. Given the "evident" and "definable benefits," and other "advantages that inure to affiliates with access to a complete local exchange . . . database," the auditors concluded that the value of the access to the database was "worth at least as much" as $400 million, the amount Pacific Bell paid SBC for the rights to the SBC corporate name. *Id.* at S12-5, S12-7. Nevertheless, Pacific has yet to be compensated a single penny for the database.

Cost misallocation of this sort causes direct harm to the long distance market and merits the strictest of scrutiny from regulators. But detecting such conduct could be made

[40] The auditors requested information from Pacific about the transfer in June, 2001, but did not receive responses for about 9 months – which is why a supplemental report was required. *Id.* at S12-1 to S12-2. The responses indicated that Pacific Bell was compensated only for the customer service labor in providing marketing services and for sales referrals, which generated about $8 million annually for Pacific Bell (*id.*) – an unconscionably low number given the market rate for referrals and the fact that other intangible assets (such as the rights to the SBC corporate name) were billed at much higher rates. *See id.* at S12-7.

impossible by the BOCs' campaign to hide such interaffiliate transfers – normally subject to section 272 – from public view. Specifically, as the California auditor noted, SBC has created "shared services affiliates" that take over functions previously performed by the BOC itself and then provide those functions to the BOC and all of its affiliates, including 272 affiliates. Thus, SBC's web site for section 272 disclosures reveals a number of publicly disclosed documents between SBC and SBC Management Services and SBC and SBC Services, Inc.[41] As a result of these transfers, these affiliates now apparently provide support services that the BOC typically provided. *See Pacific Bell Application* at 2 (requesting transfer of various support services, including IT and billing, real estate, procurement, human resources, and training). However, now that the affiliates provide these services to the BOC and other BOC affiliates, SBC does not disclose the terms of the services provided – thereby avoiding the disclosure requirements under section 272 and the Commission's rules. Thus, the SBC web site contains *no* affiliate transaction agreements between the shared services affiliates (SBCSI and SBC-MSI) and SBC's long distance and advanced services affiliates.[42]

Failure to Operate Independently. As AT&T has recently explained, Qwest has shown that it would violate perhaps the most basic requirements of section 272: to provide interLATA services only through an affiliate and to "operate independently" of such affiliates. 47

[41] *See* http://www.sbc.com/public_affairs/0,5931,1,00.html (search for "SBC Services, Inc" (39 documents) and "SBC Management Services Inc." (16 documents)) (performed July, 2002). Further, SBC applied to the California PUC to transfer a number of support services to SBC Services. *See* Amendment to Pacific Bell's Application, *In the Matter of the Application of Pacific Bell To Lease Space and Transfer Assets to SBC Services, Inc.*, A.99-07-020 (C.P.U.C. filed Oct. 1999) ("*Pacific Bell Application*").

[42] Likewise, carriers have shown how SBC is charging third party directory assistance ("DA") providers rates for access to SBC's DA databases at inflated and above-cost rates. However, it seems unlikely that SBC is imputing to itself the above-cost rate it charges to third parties. Indeed, this conduct is made all the more difficult to police because SBC has been awarded waivers of section 272 for national directory assistance.

U.S.C. §§ 272(a), (c). Specifically, in violation of the Act and the merger conditions that were imposed on Qwest's merger with US WEST (the "Merger"), Qwest continues to provide prohibited interLATA services.[43] These violations are documented in proceedings that surround audit reports filed by Qwest required by conditions on the Merger.[44] Qwest has employed three separate schemes, each of which is patently unlawful: it has used "lit fiber" "Indefeasible Rights of Use" ("IRUs"), it has provided interLATA services to customers under the guise of "corporate communications," and, most brazenly, it has directly provided interLATA services "billed and *branded* as Qwest services."[45] As AT&T demonstrated in the audit proceedings following the Merger, each of these actions is improper and violates the Act and Commission Orders. *See AT&T March 11 Comments.*

In order to bring the Qwest-US WEST merger into compliance with section 271, Qwest committed to divesting its interLATA operations in the US WEST region to an "independent" competitor, Touch America. The Commission accepted Qwest's and US WEST's representations that Touch America would not be dependent upon or controlled by Qwest and, therefore, that Qwest post-merger would not be "providing" interLATA services in violation of

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[43] The specific Qwest affiliates involved were created pursuant to its merger with U S West and are not section 272 affiliates, but the misconduct, and Qwest's ability and incentive to leverage its market power and harm interLATA competition, would be the same for any section 272 affiliates.

[44] *See* Comments of AT&T Corp. on the March 11, 2002, Audit (filed May 2, 2002) ("*AT&T March 11 Audit Comments*") Two complaints also have been filed by Touch America, Inc. ("Touch America") against Qwest that relate to the violations documented in the audits filed pursuant to the Merger conditions. *See* Complaint, *Touch America, Inc. v. Qwest, Communications International, Inc.*, File No. EB-02-MD-003 (Feb. 2002) ("*IRU formal complaint*") and Complaint, *Touch America, Inc. v. Qwest, Communications International, Inc.*, File No. EB-02-MD-004 (Feb. 11, 2002) (revised and refiled March 1, 2002) ("*Divestiture formal complaint*").

[45] *See* Letter from Arthur Anderson LLP to Dorothy Attwood (June 6, 2001), Findings 2, 7, 9 ("*June 6, 2001 Supplemental Letter*"); Report of Independent Accountants, Att. 1 at 1 (April 16, 2001) ("Initial Auditor's Report") (emphasis added) (Qwest offered services for 266 customers with associated revenues from July 2000 through March 2001 in excess of $2.2 million).

section 271. Substantial evidence demonstrates that Qwest concealed a number of steps that it took to ensure that Touch America would remain dependent on Qwest in providing services to divested customers. Apparently, immediately after the "divestiture," Qwest undertook a concerted campaign to reacquire the most valued divested customers and to provide them (and others) with prohibited in-region interLATA services.

Specifically, although Qwest assured the Commission during the Merger proceedings that Touch America would be independent of Qwest when providing in-region interLATA service, it plainly was not. Qwest, for example, assured the Commission that it would provide Touch America with sufficient access to Qwest databases so that it could support the in-region service customers being divested to it, but as explained by Touch America, "Qwest has exercised such control over the data systems and software as to prevent Touch America from independently operating or servicing Transferred Customers." *Divestiture Formal Complaint* ¶ 193. Qwest similarly assured the Commission that Touch America was not required to purchase out-of-region capacity on a wholesale basis from Qwest, but Touch America now says that Qwest's undisclosed billing system structure precluded Touch America from billing the transferred customers if it used a third party off-net provider for out-of-region capacity. *Divestiture Formal Complaint* ¶¶ 306-307. Qwest also represented to the Commission that it would lease to Touch America four circuit switches, but Touch America has now disclosed that this did not occur and that Touch America was granted only limited functionality that did not provide it "with the kind of operational control over the switches that would allow Touch America to perform the 'core functions' associated with the operational management of a switch." *Divestiture Formal Complaint* ¶ 282; *see generally id.* ¶¶ 272-292.

Qwest used these schemes as part of a winback strategy for large customers to replace private line services provided by Touch America. Thus, as set forth in Touch America's complaints, Qwest was able to reacquire Teleglobe, which was receiving leased line private line service from Touch America, by offering it lit fiber capacity IRUs. *IRU Formal Complaint* ¶¶ 75, 78. Similarly, in March 1998 Qwest announced a 15-year pre-paid private line service arrangement with Verio.[46] Verio was then divested to Touch America and reacquired by Qwest with lit fiber capacity IRUs. *IRU Formal Complaint* ¶¶ 53-54. Touch America identified four other private line customers reacquired by Qwest using lit fiber capacity and alleges that a number of government accounts were also affected.[47]

The BOCs' pervasive misconduct with respect to these supposedly independent entities demonstrates not only that section 272 requirements must be retained – in order to detect whether BOCs are, for example, providing marketing data and services to affiliates at cost – but strengthened and more vigorously enforced so that BOCs cannot succeed in hiding such arrangements from public view.

[46] *See* Verio Form S-1/A filed on May 8, 1998, Exhibit 10.25, http://www.sec.gov/Archives/edgar/data/1040956/0000950134-98-003922.txt ("*Verio/Qwest Capacity Service Agreement*")

[47] *Id.* ¶¶ 26-80. There is likewise considerable evidence that Qwest has been using in-region interLATA "corporate communications" in violation of section 271. *Divestiture formal complaint* ¶¶ 338-40, 350-54, 431-46, 506. Touch America's complaints allege that Qwest has in fact been using its "corporate communications" to provide ordinary telecommunications services to unaffiliated third parties and that these services are not permissible Official Services or incidental interLATA services. All three audit reports filed by Qwest reveal that it has, in addition to these "stealth" in-region InterLATA services, also directly provided millions of dollars of *Qwest branded* in-region interLATA services and retained a substantial portion of the revenues from such services.

D. The Biennial Audits Are Not Alone Adequate And The Audits Conducted To Date Certainly Provide No Basis For Allowing The Section 272 Safeguards To Sunset.

At this juncture, the suggestion in the *Notice* that biennial audits could by themselves adequately protect against BOC misconduct (¶ 24) or could now be relied upon as a basis to allow other section 272 safeguards to sunset (¶ 16) is entirely premature. As noted above, to date only one full audit report has been released, and the sufficiency of the biennial audit process has yet to be established.

On paper, as the Commission has recognized, the Congressionally-mandated biennial audits can be a particularly vital tool to test compliance with section 272.[48] Indeed, the Commission has determined that biennial audits should be conducted so as to provide "*stringent* post-entry oversight" and a "*thorough and systematic* evaluation" of a BOC's compliance with section 272. *BA-NY Order* ¶ 416 & n.1284 (emphasis added). Thus, at least as designed by Congress, the section 272 biennial audits are an important means by which the Commission can test the BOC's compliance with the requirements of 272.

However, only a single audit report has been released in non-redacted form, and – because of unfounded objections by the BOC regarding confidentiality of data in the report – the release of that unredacted audit report did not occur until February of this year, over *14 months* after the audit evaluation period concluded. *See generally Audit Data Disclosure Order.* A second audit report was also released, but again – and despite the Commission's prior *Audit Data*

[48] *See Accounting Safeguards Order* ¶ 197 ("To obtain a fair assessment of BOC compliance [with section 272], *we must ensure adequate oversight* . . . . Commission guidance of the audit process is crucial to assuring that the accounting and structural safeguards are in place and functioning properly. Because of the critical nature of accounting safeguards in promoting competition in the telecommunications market and the *critical role* the biennial audit will play in ensuring that the safeguards are working, it is essential that we establish effective biennial audit rules at the outset") (emphases added).

Disclosure Order – the BOC unilaterally determined that much of the relevant information in the reports could not be publicly released. These significant delays in public release of the reports – even though the Commission has determined that public comment on the audits was required by Congress and is a vital part of testing BOCs' compliance – reduce the utility of the biennial audit process.

Further, the audit reports that have been released are not being conducted with the rigor necessary to thoroughly and systematically evaluate the BOC's compliance with section 272. If these deficiencies are not addressed, the audits could never provide reliable evidence that a BOC is complying with section 272 obligations. *See* AT&T Audit Comments at 13-15, 35-39. For example, the initial audit for Verizon was woefully inadequate in many respects, failing to conduct the proper inquiries and or gather the evidence necessary to test fully Verizon's compliance with the key section 272 requirements. *Id.* at 13-35. That is not surprising, because the audit was conducted pursuant to incomplete standards and procedures that were developed without the benefit of public comment and that have never even been publicly disclosed. *Id.* at 11-12. Further, many of the inquiries in this initial audit relied upon patently inadequate measurements that are almost certain to miss or mask discrimination (because, for example, the selected measurements rely on overly aggregated data or were improperly sampled). *Id.* at 14-15, 16-18.[49] And it was often simply impossible to verify the accuracy of the results reported by the auditor, because the audit reports failed to collect or to disclose even basic data regarding the samples – such as standard deviations and population sizes – that are critical for assessing the validity of the statistical results. *See id.* at 14 & Bell Decl. ¶¶ 39-46; *see id.* ¶¶ 15-23. In short,

[49] Additionally, Verizon frequently failed to provide the data requested by the auditors, and where data was made available, the auditors violated established sampling methodologies and failed to follow requirements to examine all of the elements in some populations. AT&T Comments at 14 & Bell Dec.

because of the deficiencies in the biennial audit process, the Commission could not rely on them to conclude that a BOC has complied with its section 272 obligations, even if the audit report were to give the BOC a clean bill of health during the audit period.

Significantly, the Commission can and should improve the biennial audit process. Even the inadequate audits performed to date have revealed significant instances where the BOCs have discriminated against rivals and engaged in improper cost misallocation. However, the audits would likely expose even more misconduct if they were conducted under more rigorous standards.[50] And audits that do uncover violations of section 272 must be followed by swift enforcement action to deter future violations (and the Commission should start with imposing sanctions on Verizon's for its abysmal record of compliance with section 272). However, given the current state of the biennial audit process, the audits do not produce results that would allow the Commission to conclude that section 272 safeguards are unnecessary

E. The Pro-Competitive Benefits of Rigorously Enforced Requirements of Section 272 Far Outweigh The Costs of Compliance.

The *Notice* (¶ 21) calls for information on any efficiency loss or other costs of compliance with section 272, apparently to weigh such costs against the benefits of continued compliance. As an initial matter, such a cost/benefit analysis is not an appropriate basis on which to determine whether to extend the requirements of section 272 beyond the initial three-year period. The requirements of section 272, as implemented by the Commission, already reflect a balancing of costs and benefits by Congress – to the extent BOCs retain local market power, the

[50] For example, the performance measures relating to special access used in the first Verizon audit were plainly inadequate, and were developed years ago by Verizon to apply in Massachusetts. AT&T Audit Comments at 16-19. The Commission should replace those measures in all future audits with the proposal put forward by the Joint Competitive Industry Group in the Commission's rulemaking on special access performance measurements. *See* AT&T Special Access Comments at 23-42.

benefits of section 272 safeguards outweigh the associated costs. And the Commission itself has already determined which specific rules are necessary to implement the section 272 requirements. This balancing has been very explicit – *e.g.*, the Commission determined that the BOC and its affiliate could share certain services, but not services involving network facilities. *See Non-Accounting Safeguards Order* ¶¶ 178-83. Instead of re-evaluating the already-balanced costs and benefits of section 272, the appropriate standard for determining whether to extend these requirements is whether they still are necessary to protect consumers and competition. And plainly, as discussed above and as previously found by the Commission, so long as the BOCs have substantial market power the requirements of section 272 cannot reasonably be found to be "too costly" or unnecessary to prevent or deter anticompetitive conduct.

Nevertheless, the section 272 safeguards easily pass any reasoned cost/benefit analysis. Section 272 safeguards provide enormous pro-competitive benefits by safeguarding competition in all telecommunications markets, and particularly in the interLATA market. As the CPUC ALJ recently concluded, "we foresee harm to the public interest if actual competition in California maintains its anemic pace, and [the BOC] gains intrastate long distance dominance to match its local influence." *California ALJ Decision* at 258. Once a BOC wins section 271 approval (but retains market power), the structural and nondiscrimination safeguards of section 272 become one of the key remaining provisions in the Act that prevent a decrease in interLATA competition and that avoid the resulting harm to the public interest.

The costs of compliance with section 272 cannot be said to outweigh these substantial public interest benefits. The cost for a BOC to operate a separate affiliate for interLATA services is not at all prohibitive. In this regard, it is significant, as the *Notice* points out (¶ 13), that numerous BOCs have chosen, without any statutory requirement, to create *multiple* affiliates under section 272. If the costs of maintaining a separate affiliate were in fact substantial, then BOCs would not be creating them voluntarily. Thus, through their conduct, the BOCs have shown that the separate-affiliate requirements are not unduly costly.

In addition, many of the particular requirements of section 272 and the Commission's rules plainly do not cause the BOCs to incur any significant added costs on the BOCs. For example, under section 272(b)(5), BOCs must make their affiliate transactions transparent, through Internet posting and other disclosure obligations. Properly followed, these disclosure obligations both deter BOC/affiliate discrimination and allow competitors and regulators to police BOC conduct. Yet given the BOCs' existing obligations in preparing ARMIS reports concerning affiliate transactions, the added costs of section 272(b)(5) compliance are truly incremental.

II. THE OTHER OPTIONS PROPOSED IN THE NOTICE WOULD STIFLE COMPETITION AND ARE UNNECESSARILY COMPLEX.

A. A Three Year Extension of The Section 272 Requirements Is Appropriate.

A three-year extension of the section 272 requirements would most effectively and efficiently satisfy Congress's intent and goals of the Act generally and section 272 specifically. First, a three-year extension will allow the Commission to review the results from the second biennial audit for those BOCs that have received in-region interLATA authority. Although the biennial audits completed to date have been seriously flawed, they nonetheless provide an opportunity, if faithfully and fully completed, for a meaningful review of BOC compliance with the requirements of section 272. Properly completed audits would provide the Commission with information critical to any fair evaluation of whether market conditions, and BOC behavior, have developed to such an extent that the section 272 requirements are no longer needed.[51] And only a full three-year extension would provide the Commission with reasonable assurance that reports of such biennial audits will be available in time for the Commission and interested parties to evaluate the results in connection with a future determination on whether to sunset the section 272 requirements.

The text Congress used in the sunset provisions of section 272(f)(1) plainly affirms that Congress intended that the Commission should broadly extend the section 272 safeguards where the BOCs still maintain market power. Congress confirmed in section 272(f) that the Commission has the authority to extend the section 272 safeguards "by rule." That express language necessarily shows that Congress thought the Commission should be entitled to promulgate rules that would apply generally to all BOCs, and should not be limited merely to case-by-case adjudications even where the competitive conditions were uniform across all markets.

Finally, in light of the indisputably slow pace of competition growth in the local telecommunications markets, a three-year extension is the ***minimum*** amount of time before the Commission could reasonably consider removing section 272 safeguards on a more granular basis. In fact, given the BOCs' continued control of bottleneck facilities and the significant obstacles faced by carriers (including other BOCs) in entering these markets and providing realistic alternatives to the BOCs, it seems likely that for most BOCs, section 272 safeguards will be appropriate for an even longer period. After all, it was a full eleven years after divestiture before AT&T was deemed a nondominant carrier in the long distance market (even though it did not

[51] *See Accounting Safeguards Order* ¶ 197 (recognizing the "critical role the biennial audit will play in ensuring that the safeguards are working").

control *any* bottleneck facilities after divestiture). *See AT&T Reclassification Order* ¶ 32 (released in 1995, eleven years after divestiture became effective on Jan. 1, 1984). Compared to the pace of local competition, competition in the long distance market grew much more vigorously and broadly than has been experienced in any of the BOC local markets to date.

B. Allowing Section 272 To Sunset Would Provide Virtually No Restraint On The BOCs' Incentives and Ability to Discriminate and Cross-Subsidize.

Because the BOCs retain market power, any approach that allowed the section 272 requirements to sunset following the baseline three-year period set by Congress would be anticompetitive and against the public interest. Indeed, such an action would be patently inconsistent with the "fundamental postulate" of telecommunications law and regulation – and the underlying basis for the 1996 Act and section 272: a BOC with market power has both the incentive and ability to engage in substantial anticompetitive conduct that would directly undermine the goals of the Act. *Notice*, ¶ 3; *SBC/Ameritech Merger Order* ¶¶ 6, 32-33; *Non-Accounting Safeguards Order* ¶¶ 9-13. 206. So long as BOCs maintain their overwhelmingly dominant positions in the local market, and wield substantial market power, it would be arbitrary and unreasonable to eliminate the requirements of section 272. Indeed, given section 272's *pro-competitive* purposes of maintaining vibrantly competitive interLATA markets, nothing in the Act's purposes or goals supports elimination of the section 272 requirements where the BOCs retain the ability to harm that market.

As discussed above, it is no answer to point simply to the three-year baseline found in section 272(f)(1). To the contrary, that provision gives the Commission *authority* to extend the requirements of section 272, and Congress intended the Commission to use that authority to continue the section 272 safeguards so long as the conditions that led Congress to adopt section 272 (*i.e.*, BOC dominance of local markets) persisted.

It is also unreasonable to suggest that section 272 requirements should be eliminated because the concerns animating those requirements are addressed by the Commission's existing reporting requirements under ARMIS (47 C.F.R. § 43.21) and the annual BOC cost allocation manual filing (47 C.F.R. §§ 43.21, 64.901-64.903). By enacting the section 272 requirements in the first place, despite the existing reporting requirements under ARMIS and the cost allocation manual, Congress clearly rejected any contention that these requirements and reports are adequate to protect consumers or competition. Among other things, these reports are designed to measure services provided to end-users, not carrier-to-carrier services, and the type of information and nature of disclosures required are no substitute for the requirements of section 272. For these and other reasons, the Commission already has determined that the "[i]nformation contained in the BOC's cost allocation manual is not sufficiently detailed to satisfy section 272(b) because the BOC's cost allocation manual contains only a general description of the asset or service and does not describe all of the terms and conditions of each transaction." *Accounting Safeguards Order* ¶ 122.

C. Substituting Less Stringent Requirements For Those Impose By Section 272 Would Be Less Effective, Inconsistent With The Act, And Unnecessarily Complex And Burdensome.

It would be both be inconsistent with the Act and needlessly burdensome and complex for the Commission to choose to lift the section 272 requirements and replace them with an *ad hoc* set of partial and less stringent requirements. *See*, *e.g.*, *Notice* ¶¶ 23-26. The requirements of section 272, as implemented by the Commission, reflect a deliberate balancing of benefits to competition and to consumers arising from the requirement against the costs of compliance on BOCs and their affiliates. At least at this time, because there has been so little change in competitive conditions, there is no basis to disturb this balance. Indeed, many of the section 272 safeguards are plainly overlapping and interdependent, and all serve the same underlying purposes of helping to detect and prevent discrimination and cost misallocation. Given this interdependence and unity of purpose, no one provision is clearly severable from the rest without upsetting the separate-affiliate structure mandated by the Act.

In this regard, nothing in the Act or in the sunset provision itself suggests that the Commission should consider lifting some requirements but not others. In fact, the Act's legislative history suggests the opposite. Such a selective requirement-by-requirement approach was included in the Senate's version of the separate affiliate safeguards, with the Commission given express authority to grant exceptions to a particular requirement if it was found no longer "necessary to protect consumers or to prevent anti-competitive behavior." U.S. Cong. & Admin. News, 104th Cong., 2d Sess, H. Conf. Rep. No. 104-548, at 163 (1996). This requirement-specific approach was rejected in favor of the current sunset provision, which gives the Commission express authority to extend all the section 272 requirements.

Moreover, the section 272 obligations and the Commission's implementing rules have been in place for several years, and the costs of adapting to a different regulatory structure – costs that would be borne both by BOCs and by their rivals – are simply too high a price to pay for any perceived benefits that might arise from rules that could in theory be slightly more fine-tuned. Thus, not only would a less-restrictive set of requirements be inconsistent with the Act and section 272, but also would create added confusion and complexity. The Commission has issued numerous detailed orders on the requirements of section 272, beginning over five years ago with the *Accounting* and *Non-Accounting Safeguards Orders.* The telecommunications industry thus has been operating under the existing requirements for years, and has had an opportunity to test these requirements in the courts. Imposition of different or less-restrictive requirements now would create confusion over the precise contours of the new requirements, and necessarily raise questions over what aspects of the Commission's prior orders survived and which did not. The predictable result would be further rounds of requests for clarification or reconsideration, as well as possible court challenges, resulting in substantial administrative burdens.

These problems are amply demonstrated by the specific proposals suggested in the *Notice*. For example, one suggestion for a section 272 "substitute" (*Notice* ¶ 23) is to impose the separate subsidiary requirements established in the *Competitive Carrier Fifth Report and Order*.[52] These requirements are a wholly inadequate substitute for the requirements of section 272. Indeed, that is the only conclusion that can be drawn from Congress's decision in 1996 to enact the section 272 requirements in lieu of the longstanding rules in the *Competitive Carrier Fifth Report and Order*, which were promulgated over a decade prior to the Act. Among other omissions, the separate subsidiary requirements in the *Competitive Carrier Fifth Report and Order* do not include section 272(b)(3)'s requirement of the separate director, officers, and employees, which is critical in reducing the opportunity for discrimination, cost misallocation, and improper sharing of confidential information between the BOC and affiliate. But where there is some overlap between section 272 and the *Competitive Carrier* requirements (such as section 272(b)(2)'s requirement of separate books and records, and section 272(b)(1)'s prohibition of joint ownership of network facilities), it will only lead to uncertainty and disputes about whether

[52] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof*, CC Docket No. 79-252, *Competitive Carrier Fifth Report and Order*, 98 FCC 2d 1191 (1984) ("*Competitive Carrier Fifth Report and Order*").